United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLEE

Signed

74-2625

IN THE UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

ARTHUR L. STAIR and BERNICE STAIR,

Plaintiffs-Appellants

v.

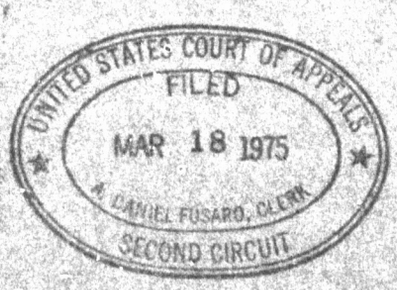
UNITED STATES OF AMERICA,

Defendant-Appellee

ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES

DISTRICT COURT FOR THE NORTHERN DISTRICT OF NEW YORK

BRIEF FOR THE APPELLE



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No. 74-2625

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v.

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ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF NEW YORK

BRIEF FOR THE APPELLEE

STATEMENT OF THE ISSUE PRESENTED

Whether the District Court was correct in granting the Government's motion for summary judgment on the ground that the taxpayers were equitably estopped from suing for a refund of 1964 taxes paid, pursuant to a settlement agreement, which they sought to repudiate after the Government was barred by the statute of limitations from asserting the balance of its claim.

STATEMENT OF THE CASE

This appeal involves a suit for refund of $39,502.54 in income taxes, plus interest, paid by the taxpayers for the calendar year 1964. (R. 5a.) 1/

1/ "R." references are to a separately bound record appendix.

Upon consideration of the briefs, stipulation of facts and supporting evidence submitted by the parties, the District Court (Honorable Edmund Port) granted the Government's motion for summary judgment on October 11, 1974, and the judgment was entered on October 30, 1974. (R. 2a.) On November 15, 1974, taxpayers filed a notice of appeal. (R. 2a.) Jurisdiction is conferred on this Court by 28 U.S.C., Section 1291.

The facts pertinent to this appeal are as follows:

The taxpayers, Arthur and Bernice Stair, timely filed their income tax return for the taxable year ended December 31, 1964, reporting thereon a gain on the condemnation of 95.396 acres of land as a long-term capital gain. Upon audit, the Internal Revenue Service determined that the gain was ordinary income rather than capital gain, and proposed a deficiency against the taxpayers for 1964 in the amount of $83,065.69, almost all of which was attributable to the ordinary income versus capital gains issue. (R. 23a.)

Negotiations were commenced on behalf of taxpayers by Mr. Bangilsdorf, an attorney and certified public accountant, and Mr. Piaker, a certified public accountant. These two representatives met with Mr. Lyden, the Internal Revenue Service appellate conferee, in August, 1966, and discussed the ordinary income versus capital gains issue. No settlement was achieved at that conference, and taxpayers' representatives recommended to Mr. Stair that the matter be litigated. (R. 23a.)

Mr. Stair was unwilling to accept the recommendation of his representatives and arrangements were made by Mr. Stair personally for a conference with Mr. Lyden. Such a conference was held in October, 1966, and was attended by only Mr. Stair and Mr. Lyden although Mr. Stair's representatives

were aware that the conference was being scheduled. (R. 24a.) At that conference, Mr. Stair offered to settle the case on the basis of treating one-half of the gain as ordinary income, and he was subsequently advised that Mr. Lyden's supervisor would find acceptable a somewhat modified settlement under which the Government would concede approximately one-half of the proposed deficiency. (R. 24a.) During November, 1966, a Form 870-AD reflecting the terms of the settlement was forwarded directly to the taxpayers as had been requested by Mr. Stair. A copy of the letter transmitting the Form 870-AD was also forwarded to taxpayers' representative, Mr. Bangilsdorf. (R. 21a.) The taxpayers executed the Form 870-AD on November 4, 1966, and it was accepted for the Commissioner on November 29, 1966. (R. 9a.) The terms of the Form 870-AD provided that taxpayers accepted the substituted proposed assessment of $41,420.54 as correct and waived statutory restrictions on assessment and collection. Further, the agreement recited that the case would not be reopened by the Commissioner "in the absence of fraud, malfeasance, concealment or misrepresentation of material fact, an important mistake in mathematical calculation, or an excessive tentative allowance of a net operating loss carryback" and that "no claim for refund or credit shall be filed or prosecuted" by the taxpayers with respect to the year in issue. The form also recited that it was not a "final closing agreement under Section 7121 of the Internal Revenue Code of 1954." (R. 9a.)

On December 30, 1966, the taxpayers paid to the Internal Revenue Service, the amount of the deficiency set forth in the executed Form 870-AD ($41,420.54), plus interest thereon. Thereafter, acting on the advice of

Mr. Bangilsdorf, the taxpayers filed a claim for refund with the Internal Revenue Service on November 25, 1968, to recover $39,502.54, plus interest, paid with respect to the ordinary income versus capital gains issue. (R. 25a.) The Internal Revenue Service disallowed the claim on March 19, 1969 (R. 25a), and this action was commenced on October 20, 1970 (R. 1a). At the time of the settlement, the deficiency which the Internal Revenue Service sought to assert was assessable in full, but when taxpayers filed their claim for refund, the one-half of the deficiency for 1964 conceded by the Internal Revenue Service was barred from assessment by the statute of limitations on assessment, Section 6501 of the Internal Revenue Code of 1954.

The District Court, in ruling on the Government's motion for summary judgment, found the taxpayers' silence until after the statute of limitations on assessments had run before filing this claim for refund had placed the Government in a position of complete detriment, in that it could no longer collect the taxes which might be due by asserting the full amount of its claim. (R. 39a.) Concluding the taxpayers should not be allowed to withhold their challenge until they have completely disarmed the Government, the District Court granted the Government's motion on the ground that taxpayers were equitably estopped from prosecuting their refund claim after the limitations period on assessing the remaining half of the originally proposed deficiency had expired. (R. 36a-40a.)

SUMMARY OF ARGUMENT

In 1966, the taxpayers and the Internal Revenue Service agreed to a settlement of taxpayers' liability for 1964. There was only one issue in controversy. The agreement was evidenced by a Form 870-AD, Waiver of Restrictions on Assessment. On November 25, 1968, after the period of limitations on assessment and collection of the balance of the proposed deficiency had run, the taxpayers sought to repudiate the settlement and reopen the merits of the liability for 1964 by filing a claim for refund.

The Government does not contend that the Form 870-AD executed by taxpayers, and accepted by the Internal Revenue Service in this case was a closing agreement or compromise satisfying the formal requirements of Sections 7121 and 7122 of the Internal Revenue Code of 1954; and thus, it does not, standing alone, bind either the Commissioner or the taxpayers to its terms. However, it is now well settled that once the Commissioner has acted to his detriment in reliance on the agreement, the taxpayers will be equitably estopped from maintaining a suit for a refund unless the Government is in a position to recover the full amount of its claim by way of setoff or equitable recoupment.

The facts of the case, which are not disputed, establish that the taxpayers agreed not to file a refund claim, and their silence after settlement led the Government to believe that no further claims would be made. Consequently, the Government allowed the statute of limitations on assessment to run without taking further action to protect its interests. Thus, the statute of limitations now bars the Government from recovering 50 percent of the proposed deficiency. Moreover, since there

was only one issue in controversy there is no opportunity for the Government to assert a setoff in this case. It would be inequitable to allow the taxpayers, who have received the benefit of a lower tax liability by reason of the settlement, even if they were to lose on the merits of the issue, to deny the terms of the agreement and claim a refund. The taxpayers have placed the Government in a "no win" position, for even if it prevails on the merits, the Government can recover nothing, and taxpayers will enjoy the benefit of the agreement in any event. Under these circumstances, the District Court correctly held that the taxpayers were equitably estopped from repudiating their settlement and properly granted the Government's motion for summary judgment.

ARGUMENT

THE DISTRICT COURT WAS CORRECT IN GRANTING THE GOVERNMENT'S MOTION FOR SUMMARY JUDGMENT ON THE GROUND THAT THE TAXPAYERS WERE EQUITABLY ESTOPPED FROM REPUDIATING THEIR SETTLEMENT AGREEMENT AND, THUS, COULD NOT SUE FOR A REFUND OF THE TAXES PAID PURSUANT TO THAT AGREEMENT

This is another case in which the taxpayers seek to repudiate the terms of a settlement embodied in a Form 870-AD. Use of the Form 870-AD has provided the Internal Revenue Service with a mechanism of great administrative importance in the orderly and expeditious processing of settlement agreements. 2/ Generally, however, such agreements do not meet the formal requirements of statutory closing agreements, or compromises under Sections 7121 or 7122 of the Internal Revenue Code of 1954, Appendix,

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2/ See generally, Hosemann, Executing Forms 870 and 870-AD, 1965 Tulane Tax Institute 285.

infra. As a nonstatutory form of settlement, the agreement concluded by the Form 870-AD enjoys no statutory protection and is, thus, supported, at least in the first instance, by the tendency of most people to honor their word. As this Court recently noted in Lignos v. United States, 439 F. 2d 1365, 1367 (C.A. 2, 1971), it has long been held that such informal settlement agreements which do not meet the specific requirements of Sections 7121 or 7122 of the Code, are not binding, per se, on either the Commissioner or the taxpayers. See Botany Mills v. United States, 278 U.S. 282, 288-289 (1929). However, as this Court also recognized in Lignos, supra, once the Commissioner has acted to his detriment in reliance on the agreement, the taxpayers may be equitably estopped from repudiating their agreement not to contest the agreed assessment. 3/ See also, e.g., General Split Corp. v. United States, 500 F. 2d 998 (C.A. 7, 1974); D.D.I., Inc. v. United States, 467 F. 2d 497 (Ct. Cl., 1972); Cooper Agency v. United States, 301 F. Supp. 871, 876-878 (S.C., 1969), aff'd per curiam, 422 F. 2d 1331 (C.A. 4, 1970).

3/ In Lignos, supra, the court reversed the judgment and remanded for further findings on the estoppel question there presented, involving the interrelationship between, and the taxpayers' representations concerning, the execution of the Form 870-AD there in question, and the settlement of a docketed Tax Court proceeding for a different year. Here, by contrast, the Government's assertion that taxpayers were equitably estopped from repudiating the agreement is based on the expiration of the limitations period on assessment and collection for the year for which the Form 870-AD was executed, and there is no factual dispute as to the execution of the agreement or the running of the applicable limitations period. Thus, the instant case was plainly appropriate for decision on the equitable estoppel issue on the Government's motion for summary judgment.

The doctrine of equitable estoppel applies to tax refund cases where: (1) there has been a false representation or misleading silence; (2) the error originates in a statement of fact rather than law or in an opinion; (3) the one claiming estoppel did not know the true facts; and (4) that same person has been adversely affected thereby. Lignos v. United States, supra. These conditions are satisfied in this case. In exchange for the Government's concession of 50 percent of the proposed deficiency, the taxpayers promised to pay the other half and not seek a refund of the amount paid. The taxpayers remained silent during the period the statute of limitations on assessment was open, but shortly after it had run they filed their claim for refund. Of course, the erroneous factual statement is the signed statement that no refund claim would be made. The Government did not know that the taxpayers would break their promise, and it relied on the taxpayers' promise that the agreement would be final and the matter closed. That promise, plus the silence of the taxpayers, caused the Government to allow the statute of limitations on assessment to expire without making any further attempt to protect itself, as, for example, by assessing the remaining half of the originally proposed deficiency in contravention to its part of the Form 870-AD agreement. The Government cannot now recover the amount it gave up in settlement with the taxpayers. Therefore, the taxpayers should not be permitted to breach the terms of their settlement by suing for the refund here claimed. As stated by the Court of Claims in Guggenheim v. United States, 77 F. Supp. 186, 196 (1948), cert. denied, 335 U.S. 908 (1949):

> It would obviously be inequitable to allow the plaintiff to renounce the agreement when the Commissioner cannot be placed in the same position he was when the agreement was executed. A clear case for the application of the doctrine of equitable estoppel exists and should be applied.

See also, Daugette v. Patterson, 250 F. 2d 753 (C.A. 5, 1957), cert. denied, 356 U.S. 902 (1958); Cain v. United States, 255 F. 2d 193, 197-199 (C.A. 8, 1958); and the cases cited in this regard in Cooper Agency, supra, pp. 876-877, fn. 8.

Of course, as the court also noted in Cooper Agency, supra, p. 877, fn. 9, there are a number of other cases where it was held that the mere fact that the limitations period on assessing the taxes given up by the Government had expired would not itself prevent the taxpayer from prosecuting a suit for refund, but such decisions appear, by and large, to be limited to circumstances where the Government might recover the full amount of its claim by way of setoff or equitable recoupment. See also, D.D.I., Inc. v. United States, supra, p. 500. For example, in Morris White Fashions, Inc. v. United States, 176 F. Supp. 760 (S.D. N.Y., 1959), the court held that the Government should not prevail on equitable estoppel grounds when it can raise the defense of equitable recoupment as a setoff to the claim for refund. Taxpayers' reliance on this case (Br. 6) is plainly misplaced. The "protection" this doctrine of equitable recoupment assertedly provides the Government in this case has not been identified by taxpayers, and indeed, clearly does not exist. Equitable recoupment cannot be found in a one issue case such as this. There is no setoff to make. If the taxpayers win, they recover the amount paid pursuant to the agreement. If the Government wins, it would no doubt be entitled to

retain the one-half of the liability already paid, but it would be prevented from collecting the balance since the limitations period on assessment and collection has expired. Thus, the Government simply cannot be made whole. As recognized in Cooper Agency v. United States, supra, p. 877, even under the decisions adopting a strict view of equitable estoppel, "where there is not a full right of set-off or recoupment by the Government, an estoppel based upon the maturing of the statute of limitation against suit by the Commission [sic], in reliance of the agreement, may properly arise."

In its recent decision in General Split Corp. v. United States, supra, p. 1004, the Seventh Circuit concluded that, where the largest part of the consideration furnished by the Government in the settlement was beyond the reach of equitable recoupment at the time the Tax Court decision became final, from that time the settlement was binding since "there was no equitable way to undo the portion of the settlement reflected in the Form 870-AD." The effect of the Tax Court decision becoming final in General Split Corp. is exactly the same as the running of the statute of limitations in a one issue case such as this. The Government is bound to the settlement, and all the consideration made by it is beyond its reach as there is no possible setoff. The taxpayers' argument that "package" settlements are somehow distinguishable is plainly without merit. Schneider v. Kelm, 137 F. Supp. 871 (Minn., 1956), aff'd, 237 F. 2d 721 (C.A. 8, 1956); Guggenheim, supra; Hunt v. United States, 175 F. Supp. 665 (E.D. Tex., 1959). Clearly, the benefit retained by the taxpayer and the detriment incurred by the Commissioner where the statute of limitations bars the Government from asserting its full claim are

precisely the same, whether the Form 870-AD involves a "package" settlement of a number of issues, whether other years or other taxpayers are involved, or whether, as here, the settlement of a single large issue is involved.

The taxpayers' further contention (Br. 10-11) that equitable estoppel does not apply to this case, because Mr. Stair didn't deceive or bribe the appellate conferee, completely misses the point. The Government has never contended that the settlement was unfair or achieved by foul deeds. The Government simply wishes that the settlement honestly reached be observed now that the Government is prevented from assessing the full liability which might be due. Moreover, there can be no claim here that the Government took unfair advantage of the taxpayers in negotiating the settlement in question. Taxpayers representatives had already discussed the matter with the appellate conferee and advised the taxpayers to litigate. (R. 23a.) But Mr. Stair wanted a settlement, and feeling he was a better negotiator, he personally met with the conferee without his representatives even though they were informed of the meeting and its purpose. The representatives were also informed by carbon copy of the settlement which had been arranged, and contacted the supervisor of the appellate conferee concerning the settlement.

The Government was, thus, clearly justified in relying on the taxpayers' promise not to seek a refund of the amount paid by them pursuant to the settlement. The taxpayers signed the Form 870-AD which was mailed to them. The language concerning prohibition of refund claims is clear, and the taxpayers acted with full knowledge of experienced representatives. Thereafter, as the District Court found (R. 39a), Mr. Stair maintained a

"studied silence" until after the statute of limitations on assessments had run to the detriment of the Government. The significance of the decision rendered in Commissioner v. Tri-S Corp., 400 F. 2d 862 (C.A. 10, 1968), was correctly recognized by the District Court (R. 43a), as merely bolstering the advice Mr. Stair had already received from his representatives before he initiated the settlement, which he now seeks to disavow. It provides no basis for relieving taxpayers from the terms of that settlement. Guggenheim, supra.

In sum, the Government has justifiably relied on this settlement to its permanent detriment. As the court stated in Schneider, supra, p. 876:

> In these circumstances equity should prevent the taxpayers from seeking to revoke their bargain after the Government has become bound to its part therein. If this would not create an estoppel, we would have the anomaly that taxpayers, if successful, would still retain the fruit of their broken bargain.

The Government here has no opportunity for a setoff. Thus, having received the benefit of reduced tax liability, even if they were to lose on the merits of the question, taxpayers here should not be allowed to repudiate their agreement and maintain this suit for a refund.

CONCLUSION

For the foregoing reasons, the judgment of the District Court granting the Government's motion for summary judgment was correct and should be affirmed.

Respectfully submitted,

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MARCH, 1975.

CERTIFICATE OF SERVICE

It is hereby certified that service of this brief has been made on opposing counsel by mailing four copies thereof on this 14th day of March, 1975, in an envelope, with postage prepaid, properly addressed to him as follows:

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APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 7121. CLOSING AGREEMENTS.

(a) Authorization.--The Secretary or his delegate is authorized to enter into an agreement in writing with any person relating to the liability of such person (or of the person or estate for whom he acts) in respect of any internal revenue tax for any taxable period.

(b) Finality.--If such agreement is approved by the Secretary or his delegate (within such time as may be stated in such agreement, or later agreed to) such agreement shall be final and conclusive, and, except upon a showing of fraud or malfeasance, or misrepresentation of a material fact--

(1) the case shall not be reopened as to the matters agreed upon or the agreement modified by any officer, employee, or agent of the United States, and

(2) in any suit, action, or proceeding, such agreement, or any determination, assessment, collection, payment, abatement, refund, or credit made in accordance therewith, shall not be annulled modified, set aside, or disregarded.

SEC. 7122. COMPROMISES.

(a) Authorization.--The Secretary or his delegate may compromise any civil or criminal case arising under the internal revenue laws prior to reference to the Department of Justice for prosecution or defense; and the Attorney General or his delegate may compromise any such case after reference to the Department of Justice for prosecution or defense.

(b) Record.--Whenever a compromise is made by the Secretary or his delegate in any case, there shall be placed on file in the office of the Secretary or his delegate the opinion of the General Counsel for the Department of the Treasury or his delegate, with his reasons therefor, with a statement of--

(1) The amount of tax assessed,

(2) The amount of interest, additional amount, addition to the tax, or assessable penalty, imposed by law on the person against whom the tax is assessed, and

(3) The amount actually paid in accordance with the terms of the compromise.

Notwithstanding the foregoing provisions of this subsection, no such opinion shall be required with respect to the compromise of any civil case in which the unpaid amount of tax assessed (including any interest, additional amount, addition to the tax, or assessable penalty) is less than $500.